

**Statement of the Honorable Mark W. Everson,
Controller, Office of Federal Financial Management, Office of Management and Budget
before the
House Subcommittee on Government Efficiency,
Financial Management, and Intergovernmental Relations**

June 26, 2002

Introduction

Thank you, Mr. Chairman, for the opportunity to appear before you on a topic that is so important to the success of our efforts to improve the Federal government's financial performance, the Single Audit Act. The Single Audit Act was designed to ensure the integrity of the manner in which we choose to distribute hundreds of billions of Federal program dollars annually. It has as its basic requirement that if you receive Federal dollars, you should be audited on a regular basis. Today, there are thousands of audits conducted in every corner of this country that give us assurance that almost all Federal grant dollars receive some level of scrutiny. In fact, current data indicate that over 95 percent of Federal grant dollars are audited under the Single Audit Act. The American people deserve to know that their investment in the Federal government is not being squandered and that it is achieving its intended purpose.

Since Congress amended the Act in 1996, we have made great strides in improving the single audit process by standardizing and streamlining Federal grant audit policies, establishing an on-line database of single audit results, and maintaining an up-to-date Compliance Supplement to assist auditors in identifying the most important aspects of Federal programs to audit. However, in the spirit of continuous improvement, we recognize that there are several areas - - including more effective follow-up on audit findings and assessing single audit quality - - that need the Administration's attention to get the most out of single audits and achieve the underlying objectives of the Act. The audits conducted under the Act are surfacing important issues. Ideally, once these issues surface, an agency should determine the extent to which the issues are systemic and take action to resolve them. This happens in many cases. However, as you will hear from the General Accounting Office, there is evidence that audit findings are not receiving adequate attention. Audit quality is another area where we have reason to be concerned. We will work through the Chief Financial Officers Council and our other partners in the Federal grants management community to improve the Act's implementation. This is an important component of our accountability to the American people.

Magnitude of Federal Grants

Before discussing single audits, it is important to understand the magnitude of Federal grants and corresponding levels of audit coverage. As Chart 1 illustrates, a large portion of the Federal budget is expended each year through Federal grants to States, local governments, and non-profit organizations - over \$317 billion, or 17 percent, of total Federal outlays for FY 2001. Mr. Chairman, that is more than we spent to defend this great country of ours last year. And we expect Federal grants to continue growing in future years. In fact, Federal grants as a percentage of total Federal outlays grew steadily, from about 11 percent in 1990 to 17 percent in 2001, and we expect future growth to about 18 percent of total Federal outlays by 2007. Chart 2 depicts

this upward trend. The increase in Federal grants is principally attributable to the growth of the Medicaid program, which increased from about \$41 billion in 1990 to \$129 billion in 2001, and we estimate \$225 billion in Medicaid outlays in 2007.

The performance of the Federal government, especially in the area of grants, hinges largely on the extent to which its partners -- States, local governments, and non-profit organizations -- have good financial management practices themselves. Medicaid depends on States health care costs on behalf of the nation's poorest citizens. The School Lunch program is administered by States and local school districts -- and schools themselves -- throughout the country. The National Science Foundation sponsors some of today's most promising scientific research. With the diversity of the government's partners comes a great deal of financial risk.

The principal tool used by the Federal government for over 15 years to mitigate risk is the single audit process. Currently, we require entities that receive \$300,000 or more in grants to subject their organizations to audit. This means that more than 95 percent of Federal grants are audited under the Act. In a moment, I will make the case that we ought to raise the threshold for audits of grant recipients, which is one of several efforts the Administration is taking to make single audits more efficient and effective.

President's Management Agenda

As you know, the President has outlined an ambitious agenda to improve the management of the Executive Branch. He chose to focus attention on those management challenges where the opportunity to improve is the greatest: Human Capital, E-Government, Competitive Sourcing, Budget and Performance Integration, and the one we are focused on today, Improved Financial Performance. As you also know, we measure an agency's progress in achieving the goals of the Improved Financial Performance initiative against criteria on the Executive Branch Management Scorecard. An agency must meet all of these criteria to get a "green" score.

Part of the President's Management Agenda is also an effort to track and reduce erroneous payments in the government's many benefit programs. The Members of this Subcommittee know this problem well. Many programs do not have sufficient controls in place to prevent payments to ineligible program participants. The Department of Housing and Urban Development reports erroneous payments in its rental subsidy programs of more than \$3 billion. Single audits are the first line of defense against erroneous payments in these and other grant programs. Single audits also serve to identify problems in program design and implementation issues across programs.

Single Audit Results - Source of Valuable Information

Single audit results are entered into a national database so we can track audit findings by program, state, or grantee. The database, called the Federal Audit Clearinghouse, is on-line and makes information from single audit reports nationwide available to the public in a consistent and comparable format. It provides a simple and convenient way for grantees to submit required reports to the Federal government as required by law. More importantly, it provides a one-stop portal to access some of the rich information that these reports provide. State and local governments, non-profit organizations, Federal agencies, and the American people have access

to audit findings on most of the Federal programs operating within the United States. This is exactly the kind of transparent accountability that we need more of in Federal financial management.

The School Lunch program, for instance, provides support to serve breakfast, lunch, snacks, and dinner to children in participating schools, including free or reduced price meals to children whose households meet income eligibility criteria. This is a compassionate program with a worthy purpose: feeding the nation's hungry children. It operates in nearly 98,000 public and non-profit schools and residential child-care institutions. When the number of children certified for free meals grew in the 1990s, even as unemployment declined and participation in other means-tested programs dropped sharply, the Department of Agriculture suspected that many of the program's participants were ineligible to participate. This suspicion was supported by single audit results which showed lack of follow-up on verifications of free and reduced price applications. School food authorities are required to verify income eligibility on a sample of applications; however through a program design flaw, results of these verifications were not reported to States or the Department of Agriculture.

Based on its suspicion that there might be systemic problems with eligibility determination nationwide, the Department of Agriculture piloted a series of demonstration projects to assess the extent of the problem. These demonstrations suggest that anywhere from 18 to 29 percent of children certified for free meals may be ineligible.

As a result of this recent study, the Administration will propose regulations requiring school districts to report the results of verification to the Department of Agriculture. We will determine the source of this problem and fix it, without overburdening schools with red tape or barring needy children access to nutritious meals. We are committed to getting to the bottom of this problem, because many Federal, State, and local programs rely on school lunch certification information to allocate funds. Accurate information is critical to ensuring that dollars targeted to low-income children reach the correct schools and children.

Another example of using single audit results relates to the former Aid to Families with Dependent Children program. Many States simply retained overpayments made in this program which should have been returned to the Department of Health and Human Services. As a result of single audit findings, the department's Office of Inspector General initiated reviews in many States which have resulted in recoveries of over \$20 million. The Office of Inspector General estimates that full recovery could be double this amount.

Yet again, under Medicaid program requirements, State agencies must conduct information technology system security reviews over the Medicaid systems (e.g., eligibility and payments systems). This requirement was first listed for auditors to test in 1997 in the Office of Management and Budget's first Compliance Supplement under the revised Circular A-133. Auditors initially cited many compliance problems for which States have taken corrective action and this is no longer a significant problem area. Single audit findings resulted in States addressing information technology security issues well in advance of many Federal agencies and private sector entities.

These are examples of what can be done with single audit data. It can provide us with sufficient information to determine major flaws in program administration or design that not only put tax dollars at risk, but severely hamper a program's chances of success.

Is the Information Being Used?

Mr. Chairman, you will hear more from those who operate the clearinghouse on behalf of the Administration. But our records on access to the website where the information is available show that some agencies are accessing the Federal Audit Clearinghouse database with increasing frequency. Hits for the purpose of entering information from audits have increased sharply, from 32,000 in FY 2001 to 80,000 in just the first 8 months of FY 2002. More significantly, from a financial performance standpoint, was the increase in access to the database by users who were seeking information on audits available on-line. Such access nearly doubled, jumping from 1,400 hits to 2,600 over the same time period. And thanks to our friends at the Clearinghouse, we can take a peek at which Federal agencies are making use of this very important data. The top Federal agency users of the Clearinghouse's Internet Dissemination System in FY 2001 were the following: the Departments of Justice, Housing and Urban Development, Health and Human Services, and the Interior; the Corporation for National and Community Service; the Environmental Protection Agency; the National Science Foundation; and the General Accounting Office. But we are clearly not using the information gleaned from single audits to its full advantage.

The General Accounting Office is reporting today that several agencies, namely the Departments of Education, Housing and Urban Development, and Transportation, are not doing enough to address findings identified by single audits. In its investigation, the General Accounting Office learned that the agencies could not provide sufficient documentation to show that they had even followed up on 171 of 246 substantive findings. The best effort was in the Pell Grant program, which offers higher education student financial assistance. As you know, there is a documented erroneous payment problem with the Pell Grant program. The least impressive effort to follow up on audit findings was in the Department of Transportation's Highway Planning and Construction Grants program. This is a weakness that must be remedied. I am glad to say the department has recently instituted a recovery audit program to assess the extent of erroneous payments in the Highway Planning and Construction Grants program. This should be just one part of identifying areas of concern in programs and following up to ensure they are corrected.

I fully support the General Accounting Offices's recommendations to reinforce our current procedures for following up on single audit findings. The General Accounting Office rightly points out that use of single audit data could be a useful tool to identify causes of erroneous payments, a priority on the President's Management Agenda. The Office of Management and Budget, working with the Chief Financial Officers Council, the Federal grants management community, and the Federal Audit Clearinghouse, will step up training and outreach efforts so that program managers are aware of, and make better use of, audit results and other available information to oversee Federal grant programs. The basic information infrastructure is in place – now, we need to make sure that the information is used to actively improve Federal grant programs.

Audit Quality

Clearly, if we rely on single audits to buttress Federal accountability and for audit follow up to be valuable, the audits must be thorough and reliable in the first place. Recent reviews raise concerns with the quality of audits conducted pursuant to the Single Audit Act. These reviews, called Quality Control Reviews, are performed by Federal agencies. Some have identified significant audit quality problems and these may be pervasive. For example:

- The Departments of Health and Human Services and Education Offices of Inspector General have found auditors are not properly selecting the Federal programs to be tested during a single audit. The result is that Federal programs which should have been tested were not. The Department of Health and Human Services has already referred over 35 auditors to professional bodies for possible disciplinary action and is currently considering additional referrals. The Department of Education is following up to require corrective action for programs not tested.
- The Department of Labor Office of Inspector General reviewed six audits and found that auditors did not perform adequate tests in a majority of these cases, and in some cases gathered no evidence at all for specific compliance requirements. (This report on these reviews is available on the Internet at www.oig.dol.gov/public/reports/oa/2002/22-02-011-50-598.pdf)
- The Department of Housing and Urban Development Real Estate Assessment Center performs quality control reviews on Housing Authorities. The Center reportedly completed 66 quality control reviews of 14 independent auditors. As of September 30, 2001, 35 percent of the auditors (and possibly more) did not perform adequate testing in accordance with the Compliance Supplement.

We believe these specific examples of audit quality problems are significant. However, since the selection of audits for quality control review is not statistically-based, we do not know whether the problems noted significantly diminish Federal grant-making agencies' ability to rely on single audits to ensure accountability for Federal grants. We need an accurate measure of audit quality and it needs to be statistically based. The measure needs to include both a baseline of the current status and the means to monitor quality in the future.

We recognize the importance of garnering and coordinating Federal resources to assess single audit quality. The Office of Management and Budget, working through the Chief Financial Officers Council and the Grants Management Committee, will establish an inter-agency, interdisciplinary task force to assess single audit quality. The task force will develop a statistically-valid measure of current single audit quality. This task force will consult with the General Accounting Office, the Offices of Inspector General, the National State Auditors Association, and other single audit constituents. Also, the plan will include a follow-up process to improve and monitor audit quality over time. The Office of Management and Budget anticipates agencies will be in place to begin measuring the quality of audits submitted to the Federal Audit Clearinghouse during 2002.

Focus Audits Where Federal Risk Is Greatest

As I mentioned earlier, the Office of Management and Budget is working toward increasing the audit threshold amount from \$300,000 to \$500,000. The Single Audit Act provides for the Director of the Office of Management and Budget to review the single audit threshold and increase it as appropriate. The current audit threshold requires all grantees that expend \$300,000 or more in a year in Federal awards to have an audit conducted in accordance with Circular A-133. As shown in the following table, an audit threshold increase from \$300,000 to \$500,000 would relieve 6,000 entities from the audit requirements of Circular A-133 while retaining audit coverage for 99.5 percent of Federal awards currently audited (in dollars). Raising the threshold makes sense, as it reduces the burden on smaller non-Federal entities and concentrates scrutiny where the Federal risk is the greatest.

<u>Federal Awards Expended Range</u>	<u>Number of Entities Audited</u>	<u>Percent of Entities Audited</u>	<u>Percent of Federal Awards Expended Within Range</u>
\$300,000 to \$500,000	6,000	18%	.5%
\$500,000 and above	28,000	82%	99.5%
Total	34,000	100%	100.0%

Administration Actions

In 1996, Congress wisely enacted the Single Audit Act Amendments of 1996. At that time, studies of the single audit process performed by the General Accounting Office, the President's Council on Integrity and Efficiency, and the National State Auditors Association cited the need for a regularly updated Compliance Supplement, the Federal government's road map to the auditors on the key compliance requirements which auditors should test. The National State Auditors Association study stated: "The Compliance Supplement provides an invaluable tool to both Federal agencies and auditors in setting forth the important provisions of Federal assistance programs. This tool allows Federal agencies to effectively communicate items which they believe are important to the successful management of the program and legislative intent . . . Such a valuable tool requires constant review and update."

Since 1997, the Office of Management and Budget annually has updated and enhanced the Supplement which now provides guidance on over 150 Federal programs with the assistance of Federal grant-making agencies. We recently undertook an exhaustive update of the Compliance Supplement, and I have provided it to the Members of this Subcommittee on CD-ROM. In addition to providing detailed guidance to auditors throughout the nation, the Supplement gives descriptions of the many Federal programs that are administered on behalf of the Federal government and the eligibility and other requirements for participation in the programs. Without this Supplement, auditors of over 34,000 entities would each have to research the many laws and regulations governing each program under audit to determine which compliance requirements are important to the Federal government and could have a direct and material effect on a program's financial performance. The Supplement is a source of information for auditors to understand the Federal program's objectives and suggested audit procedures for determining compliance with these requirements.

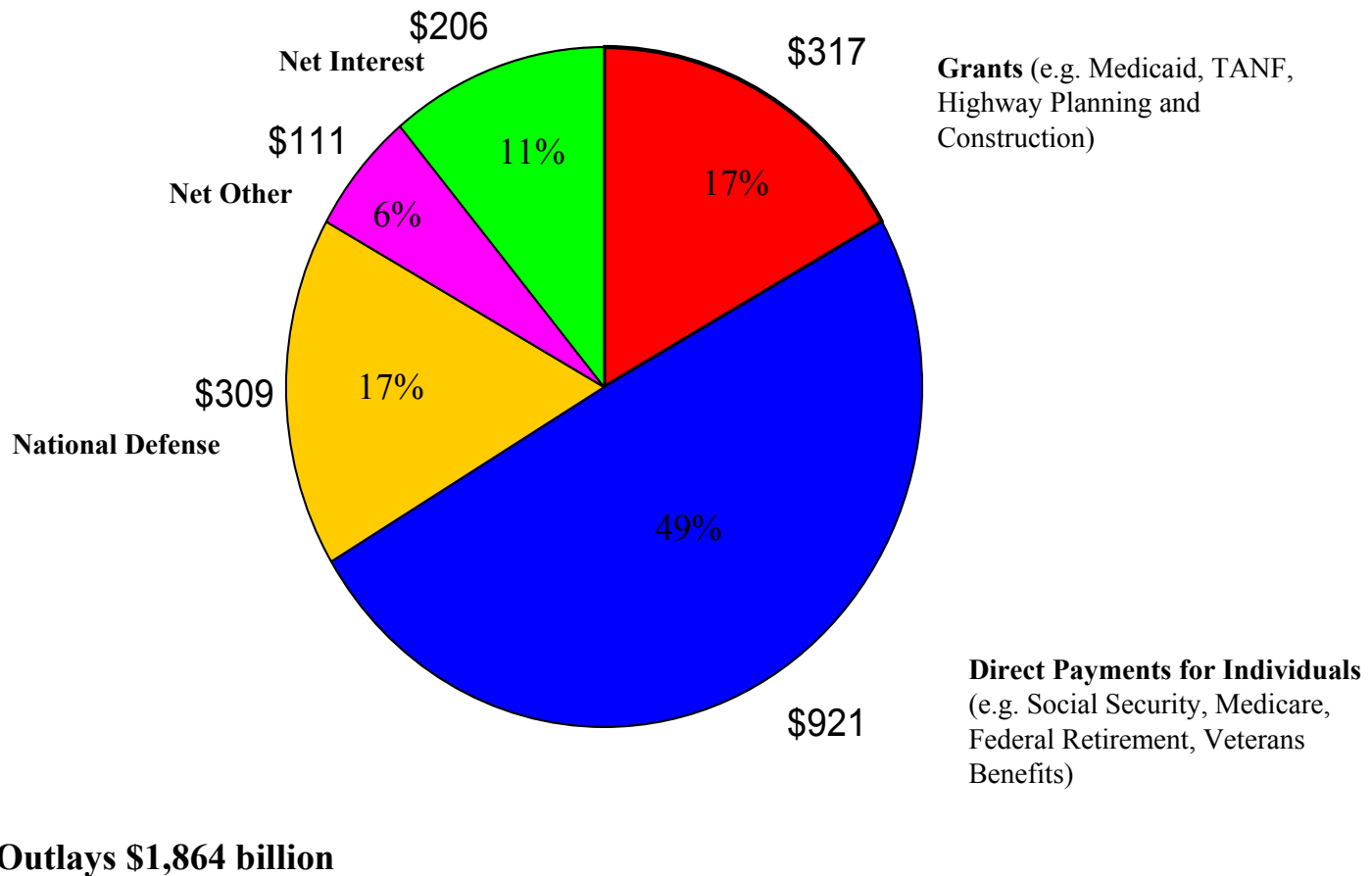
We will continue to update this important resource annually, providing the guidance necessary to ensure that our tax dollars are audited efficiently and effectively. And like in the past, where we find evidence that the Single Audit Act implementation is flawed, we will work to correct those flaws. We are taking actions to ensure that findings are addressed and audit quality is ensured. In addition, we will continue our work to raise the audit threshold from \$300,000 to \$500,000.

As I have stated, the Single Audit Act provides the Administration, Congress, and the American people assurance that States, local governments, and non-profit organizations that administer Federal programs are being scrutinized. These parties are an important component of the Federal government's efforts to serve the American people and demonstrate accountability over Federal tax dollars. These audits allow us, to some extent, to determine whether our programs are meeting their goals. While we believe the single audit process is working well, we have identified key areas that warrant attention – audit quality, making better use of single audit results, and increasing the audit threshold – so that the underlying objectives of the Act will be achieved. This Administration is committed to addressing these areas to strengthen single audits in the future and ultimately improve the administration of Federal grants.

Thank you, Mr. Chairman. I look forward to answering your questions.

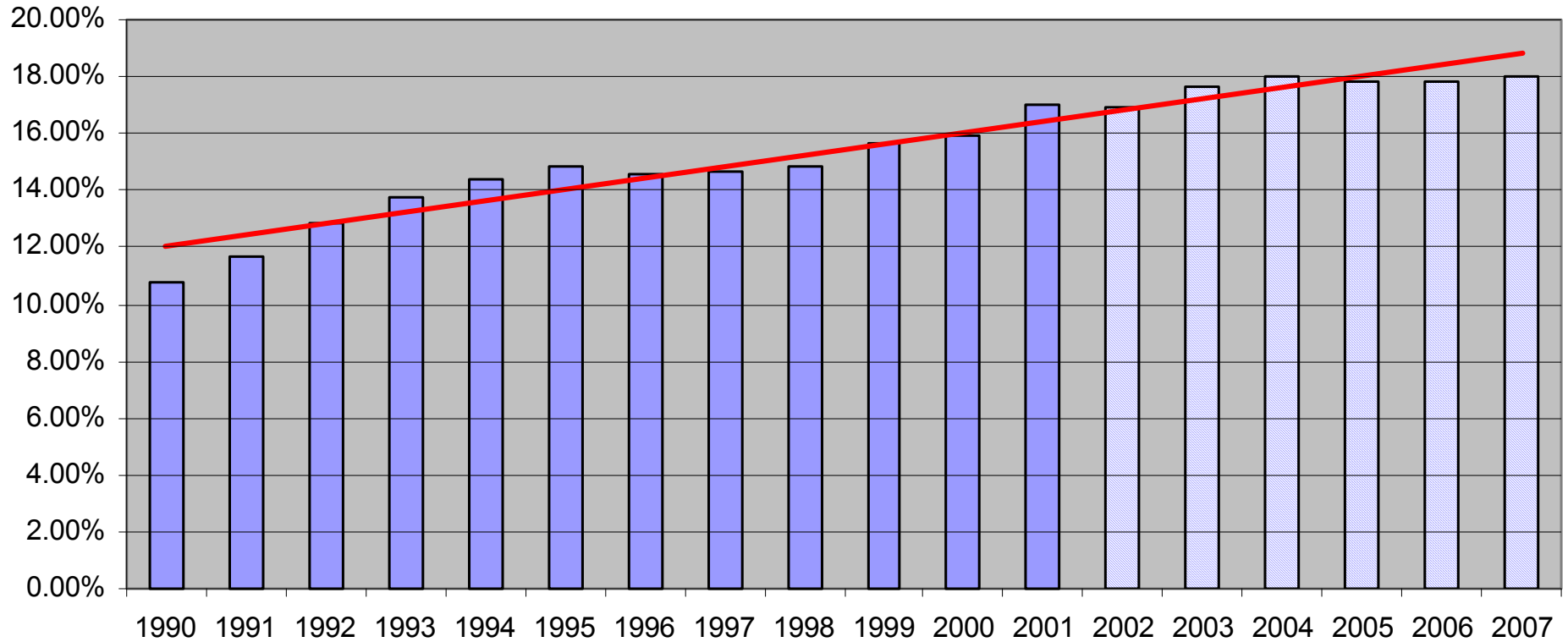
Composition of Federal Outlays: FY 2001 (Chart 1)

(billions)



Grants as a % of Total Federal Outlays (Chart 2)

1990 - 2007



Actual Estimated